

State of California

The Resources Agency

M e m o r a n d u m

Date: November 5, 2001

To: The Honorable Geoffrey Brown, Commissioner
California Public Utilities Commission

From: Thomas M. Hannigan
Department of Water Resources

Subject: Notification of Revised Revenue Requirement Pursuant to Water Code
Section 80110

This notification is transmitted by the California Department of Water Resources (the "Department") and updates and replaces the Department's August 7, 2001 Revenue Requirement delivered to the California Public Utilities Commission ("PUC" or the "Commission"). Enclosed herewith is the Department's Determination of Revenue Requirements (the "Determination") adopted pursuant to Water Code Section 80110.

BACKGROUND

On October 19, 2001, the Department released a Draft Determination of Revenue Requirements (the "Draft Determination") setting forth the Department's proposed determination of its revenue requirements in accordance with Division 27 of the California Water Code. On October 22, 2001, the Department conducted a workshop relating to such Draft Determination at which representatives of the Department provided an overview of the Draft Determination and responded to questions and comments related thereto. The Department also held a conference call with certain parties on its model and accepted written comments on the Draft Determination from all interested persons as described therein.

In connection with its adoption of the enclosed Determination, the Department also consulted with PUC staff and considered questions and comments it has received in response to the release of its Draft Determination as well as written questions from the investor-owned utilities (IOUs) and other parties raised during the course of the PUC's proceedings relating to the Department's earlier revenue requirement notifications to the PUC.

The Department has determined that the revenue requirements contained in the enclosed Determination are just and reasonable.

NEED FOR EXPEDITED ACTION BY COMMISSION

The Department appreciates the Commission's efforts to date in considering issues relating to the charges that are to be applicable to Department furnished power.

As you are aware, the Department is obligated under Division 27 of the Water Code to repay the advances made from the General Fund as soon as practicable. We believe that under the current economic circumstances facing the State, the importance of doing so is self-evident. To that end, it is essential that the Commission act on the Department's revenue requirement as submitted herewith and establish charges for Department power on the schedule published by the Assigned Commissioner, with no further delay. We understand that this schedule contemplates that a rate order will be adopted at or near the end of 2001.

The prompt establishment of charges for Department power in accordance with the Water Code will assist the Department in its effort to secure lower cost long term financing, permitting the Department to reduce the revenue requirements that would otherwise be payable by retail end use customers. As discussed in the Determination, in the event that the sale of the bonds is not imminent by mid-2002, it may be necessary to increase the Department's revenue requirements to assure that the Department's revenues are sufficient to comply with its term-out, interest rate step-up and other obligations related to the interim financing.

We are certain that the Commission shares the desire to implement the legislature's directive that the General Fund be repaid as soon as practicable and trust that it will take notice of the importance that repaying the General Fund has in the circumstances presently faced by the State. Time is of the essence in this matter, now more than ever. The Department stands ready to provide additional assistance to the Commission to permit the Commission to establish charges for Department power at or near the end of 2001.

ADJUSTMENTS TO THE REVENUE REQUIREMENT

The Department prepared the Determination to reflect various changes since the Revenue Requirement delivered to the Commission on August 7, 2001. These changes are enumerated in the Determination. In summary, the principal changes include:

1. Changes to the load forecast to reflect the increase in direct access loads resulting from the Commission established September 20, 2001 cutoff date for retail end-users to enter into contracts with alternative electric service providers;
2. Changes to the Department's financing requirements principally resulting from the inability of the Department and the Commission to reach agreement on the form of a rate agreement and the resultant delay in the issuance of long-term bonds to refinance the Department's interim loan;
3. Changes to the assumptions regarding future natural gas prices;
4. Changes to the load forecast to reflect the effects of only the 20/20 Program for the year 2001 and those demand-side management and conservation related activities which have been authorized by legislation;
5. Changes to the amount of power under long-term Department contracts;
6. Changes to the methodology for calculating ancillary service costs;

7. Changes in the estimated prices received by the Department for sales of its contracted power to wholesale power purchasers; and
8. Certain changes in the timing of the receipt of revenues by the Department.

The Department's review and analysis of oral and written comments on its Department's October 19th draft determination also resulted in changes including:

1. Changes to the Department's interim financing rolling coverage requirement;
2. Changes to the Department's accounting of cash flows, due to cash reporting of the Power Fund received by the Department from the Department of Finance; and
3. Updated actual volumes and costs of the net short, ancillary services and associated California Independent System Operator charges.

The California energy market and the Department's role in it continue to evolve rapidly. During the period covered by this revenue requirement determination, changes may occur in responsibility for the provision and/or cost of ancillary services, the residual net short and, ultimately perhaps, the entire net short. This revenue requirement determination is based on the Department's current status in the market. If and when circumstances change in a manner that results in material changes in the Department's relative costs and revenues, the Department will adjust the requirements stated in the Determination.

EXHIBIT:

Determination of Revenue Requirement dated November 5, 2001, with Exhibits